

Message Text

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SUBJECT: GOB MODIFIES SYSTEM OF FISCAL INCENTIVES FOR PRIORITY
ECONOMIC AREAS

1. SUMMARY: THE ECONOMIC DEVELOPMENT COUNCIL (CDE)
APPROVED JUST BEFORE THE HOLIDAYS A DECREE LAW CHANGING THE
SYSTEM GOVERNING THE APPLICATION OF RESOURCES
GENERATED BY FISCAL INCENTIVE PROVISIONS, TO PRIORITY
ECONOMIC AREAS (NORTH NORTHEAST, TOURISM, FISHERY AND
REFORESTATION). THREE NEW "SUPER" FUNDS, TO BE
ADMINISTERED BY STATE-OWNED FINANCIAL INSTITUTIONS, HAVE
BEEN CREATED TO CHANNEL RESOURCES INTO THESE AREAS.
EXISTING REGIONAL AND SECTORAL DEVELOPMENT AGENCIES
WILL PROVIDE OVERALL SUPERVISION OF THE FUNDS,
DETERMINING THE PRIORITY AREAS IN ACCORDANCE WITH THE
NATIONAL DEVELOPMENT PLAN. THE NEW SCHEME HAS COME
UNDER CRITICISM FROM THE FINANCIAL AND INVESTING
COMMUNITIES ON THE GROUNDS THAT IT REPRESENTS ANOTHER
STEP TOWARD "ETATISM". THE PRINCIPAL CONCERN OF THESE
CRITICS IS THE FEAR THAT THESE "SUPER" FUNDS WILL TEND TO
FAVOR GOVERNMENT-SPONSORED PROJECTS. UNDER NEW SYSTEM,
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THE GOVERNMENT WILL NOT ONLY DETERMINE PRIORITY AREAS,

AS IN THE PAST, BUT WILL ALSO DECIDE WHICH SPECIFIC PROJECTS ARE ELIGIBLE FOR FISCAL INCENTIVE FUNDS -- A DECISION WHICH, THEREFORE, HAD BEEN LEFT TO THE INDIVIDUAL INVESTOR. IN A RECENT SPEECH, FORMER FINANCE MINISTER EUGENIO GUNDIN CRITICIZED ROLE OF GOVERNMENT IN THE ECONOMY. END SUMMARY

2. THE ECONOMIC DEVELOPMENT COUNCIL (CDE) APPROVED JUST BEFORE THE HOLIDAYS A DECREE LAW MODIFYING THE SYSTEM GOVERNING THE APPLICATION OF RESOURCES GENERATED BY FISCAL INCENTIVE SCHEMES FOR THE DEVELOPMENT OF THE NORTH, NORTHEAST, ESPIRITO SANTO, TOURISM, FISHERIES AND REFORESTATION. THE NEW SYSTEM CONSOLIDATES THE APPLICATION OF THESE RESOURCES INTO THREE "SUPER" FUNDS TO BE ADMINISTERED BY THREE DIFFERENT STATE-OWNED FINANCIAL INSTITUTIONS. FUNDS FOR THE NORTHEAST WILL NOW BE CHanneLED THROUGH FINOR, A FUND TO BE ADMINISTERED BY BANCO DO NORDESTE DO BRASIL, UNDER THE GENERAL SUPERVISION OF SUDENE. FUNDS FOR THE NORTH WILL BE CHanneLED THROUGH FINAM, A FUND TO BE ADMINISTERED BY BANCO DA AMAZONIA, UNDER THE GENERAL SUPERVISION OF SUDAM. FUNDS FOR TOURISM, FISHERIES AND REFORESTATION WILL BE CHanneLED THROUGH FISET, A FUND TO BE ADMINISTERED BY BANCO DO BRASIL; FISET WILL CARRY THREE ACCOUNTS, WHICH WILL BE SUPERVISED BY EMBRATUR (TOURISM), SUDEPE (FISHERIES), AND IBDF (REFORESTATION), RESPECTIVELY.

3. THIS NEW SCHEME APPLIES TO COMPANIES (PESSOAS JURIDICAS) WHICH CHOOSE TO TAKE ADVANTAGE OF EXISTING FISCAL INCENTIVES FOR INVESTMENTS IN PRIORITY ECONOMIC AREAS. FISCAL INCENTIVES FOR INDIVIDUALS ARE GOVERNED BY DECREE LAW 1338 (SEE BRASILIA 6826 OF AUGUST 2, 1974). INDIVIDUALS RECEIVE A TAX CREDIT (WITH LIMITS) FOR THE PURCHASE OF STOCKS AND BONDS OF COMPANIES AND/OR AGENCIES INVOLVED IN THE DEVELOPMENT OF PRIORITY SECTORS OF THE ECONOMY.

4. THE NEW SCHEME REPLACES A SYSTEM WHICH ALLOWED COMPANIES (AS TAXPAYERS) TO INVEST DIRECTLY INTO UNCLASSIFIED

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PROJECTS (USUALLY OTHER COMPANIES) IN PRIORITY SECTORS OF THE ECONOMY. THROUGH THE YEARS, HOWEVER, THE OLD SYSTEM HAD APPARENTLY DEVELOPED A NUMBER OF SHORTCOMINGS WHICH LED THE GOVERNMENT TO REVAMP IT. THE CDE GAVE THREE MAJOR REASONS TO JUSTIFY THE MODIFICATION: (A) THE OLD SYSTEM DID NOT NECESSARILY EQUATE SUPPLY AND DEMAND FOR FUNDS (IN THE LAST FEW YEARS, DEMAND FOR RESOURCES FROM

FISCAL INCENTIVES FAR EXCEEDED SUPPLY); (B) AS A RESULT OF THESE SHORTAGES, MANY PROJECTS IN THE AFFECTED AREAS HAVE SUFFERED IMPLEMENTING DELAYS WHICH AT TIMES HAVE SUFFERED PROJECTS TO RUN INTO FINANCIAL DIFFICULTIES BEFORE COMPLETION; AND (C) THE IMBALANCE BETWEEN SUPPLY AND DEMAND FOR FISCAL INCENTIVE FUNDS LED INTERMEDIATING INSTITUTIONS TO CHARGE EXORBITANT BROKERAGE AND COLLECTING COMMISSIONS (THROUGH THE YEARS A NUMBER OF SPECIALIZED FINANCIAL INSTITUTIONS HAVE DEVELOPED TO INTERMEDIATE BETWEEN SOURCES AND USES OF FISCAL INCENTIVE RESOURCES).

5. THE BASIC POINTS OF THE NEW SCHEME ARE AS FOLLOWS: (A) EXISTING RATES FOR THE VARIOUS FISCAL INCENTIVE SCHEMES REMAIN UNCHANGED; (B) COMPANIES (PESSOAS JURIDICAS) WILL CONTINUE TO INDICATE ON THEIR INCOME TAX RETURN THE AMOUNTS THEY WISH TO INVEST AND WHELK; (C) THE RESOURCES SO GENERATES WILL BE CHanneLED INTO THE INDICATED AREAS THROUGH THE THREE "SUPER" FUNDS; (D) THE REGIONAL AND SECTORAL DEVELOPMENT AGENCIES WILL CONTINUE TO DEFINE THE PRIORITIES AND ANALYZE AND APPROVE PROJECTS WHICH ARE ELIGIBLE FOR FISCAL INCENTIVE FUNDS; THEY WILL ALSO AUTHORIZE THE OPERATING BANKS EITHER TO FINANCE THESE PROJECTS OR TO BUY SHARES IN THEM; (E) THE RESOURCES OF THE THREE "SUPER" FUNDS WILL COME FROM FISCAL INCENTIVES, OPERATING PROFITS AND OTHER SOURCES WHICH MAY BE PROVIDED BY LAW; IN ADDITION, THE FEDERAL GOVERNMENT CAN SUBSCRIBE TO SHARES OF THESE FUNDS, WHICH WOULD NOT BE CONVERTIBLE INTO STOCKS; AND (F) THE RESOURCES OF THE FUNDS WILL BE INVESTED IN STOCKS, CONVERTIBLE AND NON-CONVERTIBLE UNCLASSIFIED

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DEBENTURES AND LOANS OF ELIGIBLE COMPANIES. HOWEVER, IF A COMPANY (OR GROUP OF COMPANIES) CURRENTLY HOLDS 51 PERCENT OF THE VOTING STOCK OF A FIRM IN ONE OF THE PRIORITY AREAS, THE TRANSFER OF THE RESOURCES FROM ONE FIRM TO THE OTHER CAN CONTINUE TO TAKE PLACE DIRECTLY, WITHOUT GOING THROUGH THE FUNDS.

6. ACCORING TO THE CDE, THE NEW SYSTEM HAS THE FOLLOWING ADVANTAGES (A) IT ASSURES EQUILIBRIUM BETWEEN SUPPLY AND DEMAND FOR RESOURCES SINCE THE APPROVING AGENCIES WILL BE REQUESTED TO SUBORDINATE THEIR PROJECTED INVESTMENT OUTLAYS TO AVAILABLE FUNDS; (B) IT PROVIDES FOR THE GOVERNMENT TO PUT ADDITIONAL RESOURCES AT THE DISPOSAL OF THE FUNDS (WITHOUT AT THE SAME TIME PARTICIPATING AS A STOCKHOLDER

IN THE PROJECTS SINCE GOVERNMENT-HELD SHARES IN THESE FUNDS ARE NOT CONVERTIBLE); AND (C) IT ELIMINATES THE COMMISSION FORMERLY CHARGED BY THE INTERMEDIARIES, REDUCING THE COST OF MONEY TO BORROWERS.

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ACTION ARA-10

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UNCLAS FINAL SECTION OF 2 BRASILIA 0079

7. THESE "SUPER" FUNDS ARE TO BE OPERATED AS INVESTMENT FUNDS. AS SUCH, COMPANIES WHICH CHOOSE TO TAKE ADVANTAGE OF FISCAL INCENTIVES WILL NOW RECEIVE FROM THE FEDERAL REVENUE SERVICE CERTIFICATES OF OWNERSHIP (CERTIFICADOS DE APLICACAO) IN FINOR, FISET AND FINAM. THESE CERTIFICATES WILL CARRY AS FIXED CRUZEIRO VALUE AND MUST, WITHIN A MAXIMUM OF ONE YEAR, BE CONVERTED INTO SHARES OF THE RESPECTIVE FUNDS OR IN STOCKS OF EMBRAER (GOVERNMENT-OWNED AIRCRAFT COMPANY). SHARES IN FINOR, FINAM, FISET CAN, IN TURN, BE CONVERTED INTO STOCKS OF COMPANIES WHICH HAVE RECEIVED FINANCIAL BENEFITS FROM THE FUNDS. SUCH STOCKS, HOWEVER, CAN ONLY BE NEGOTIATED FOUR YEARS AFTER PURCHASE. THE SHARES, ON THE OTHER HAND, CAN BE FREELY NEGOTIATED, BUT CANNOT BE CASHED IN; THEY MAY ALSO BE USED AS A GUARANTY OR COLLATERAL IN DEALINGS WITH GOVERNMENT (FINANCIAL) INSTITUTIONS.

9. COMMENT: THE REACTION TO THE PASSAGE OF THE DECREE LAW HAS BEEN GENERALLY NEGATIVE. THE INVESTMENT BANKERS ASSOCIATION, WHOSE MEMBERS WERE THE MAIN BENEFICIARIES OF THE OLD SYSTEM IN THAT THEY UNCLASSIFIED

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PERFORMED MOST OF THE INTERMEDIATION BETWEEN SOURCES AND USES OF RESOURCES FROM FISCAL INCENTIVES, ISSUED A STRONG STATEMENT CRITICIZING THE NEW SCHEME. THE GOVERNMENT IS ALSO BEING CRITICIZED FOR HAVING FAILED TO INCORPORATE INTO THE FINAL DRAFT MANY OF THE SUBSTANTIVE SUGGESTIONS MADE ON A PRELIMINARY VERSION OF THE DECREE CIRCULATED IN THE FINANCIAL AND BUSINESS COMMUNITIES. MAJOR NEWSPAPERS HAVE CARRIED EDITORIALS CRITICAL OF THIS GOVERNMENT MOVE. THE COMMON THREAD OF THESE CRITICISMS IS THAT THE LATEST GOVERNMENT ACTION REPRESENTS ANOTHER STEP TOWARD "ETATISM". THE PRINCIPAL FEAR OF THE CRITICS IS THAT THE NEW FUNDS WILL BE BIASED IN FAVOR OF GOVERNMENT-SPONSORED PROJECTS; THE PRIVATE INVESTOR WILL NO LONGER HAVE THE FREEDOM TO CHOOSE THE INDIVIDUAL PROJECT HE WISHES TO FINANCE (UNLESS HE ALONE OR AS PART OF A GROUP ALREADY OWNS 51 PERCENT OF THE FIRM RECEIVING THE FUNDS).

10. THIS GENERAL CONCERN WITH THE ROLE OF GOVERNMENT IN THE ECONOMY WAS HIGHLIGHTED RECENTLY IN A SPEECH BY EUGENIO GUDIN, FORMER MINISTER OF FINANCE -- A SPEECH WHICH RECEIVED CONSIDERABLE PLAY IN THE PRESS. GUDIN SAID, INTER ALIA, "WE LIVE, IN PRINCIPLE, IN A CAPITALIST SYSTEM, BUT BRAZILIAN CAPITALISM IS MORE CONTROLLED BY THE STATE THAN IN ANY OTHER COUNTRY, WITH THE EXCEPTION OF COMMUNIST COUNTRIES." HE NOTED SPECIFICALLY, IN THIS REGARD, THE "ABSORPTION" BY THE STATE OF INDUSTRIES LIKE STEEL, PETROLEUM, RAILWAYS, TELECOMMUNICATIONS, NAVIGATION, ELECTRIC ENERGY, AND A BIG PORTION OF THE BANKING SECTOR. HE CONTINUED: "...THE DOMINANCE OF THE ECONOMY BY THE STATE HAS ALREADY BEEN NOTED BY FOREIGN FIRMS, WHICH MAY ADVERSELY AFFECT THE FLOW OF CAPITAL INTO BRAZIL".

11. APPARENTLY STUNG BY THE SEVERE CRITICISMS, GOVERNMENT OFFICIALS HAVE GONE ON THE ATTACK DURING THE PAST FORTNIGHT. FINANCE MINISTER SIMONSEN HAS REITERATED ON SEVERAL OCCASIONS THE GOVERNMENT'S SUPPORT FOR THE DEVELOPMENT OF THE PRIVATE SECTOR, UNCLASSIFIED

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PREDICTING THAT 1975 WILL BE THE YEAR OF THE PRIVATE
SECTOR INsofar AS GOVERNMENT ACTIONS ARE CONCERNED.
(HE HAS ALREADY PROMISED NEW CORPORATE LEGISLATION).
THE MINISTER OF INDUSTRY AND COMMERCE IN A RECENT
SPEECH JUSTIFIED GOVERNMENT PARTICIPATION IN PETRO-
LEUM, STEEL AND OTHER KEY INDUSTRIES ON THE GROUNDS
THAT, UNLESS IT INTERVENED, FOREIGN INTERESTS WOULD
HAVE TAKEN THEM OVER -- THUS RESULTING, HE MAINTAINED,
IN AN UNACCEPTABLE LEVEL OF FOREIGN OWNERSHIP IN
THESE AREAS.
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